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SUBJECT: TWIN DEFICITS CHALLENGE GHANA

¶1. SUMMARY: Ghana's budget and current account deficits constitute major challenges to Ghana's macroeconomic performance in 2009. Corresponding with the deficits, Ghana's cedi continues its fall against world currencies, driving domestic inflation beyond 20 percent. Growth in 2008 has been provisionally estimated at a strong 6.2 percent, but growth will likely drop in 2009, partially due to tighter credit. Ghana's ability to restore fiscal and monetary stability will be a key task for the current government, which may eventually be forced to seek IMF assistance. END SUMMARY.

A HUGE FISCAL DEFICIT

¶2. (U) Unrestrained government spending in 2008 resulted in a budget deficit of 14.9 percent of GDP (excluding divestiture) or 11.5 percent of GDP (including privatization proceeds). Given the election year context, the large deficit was partially caused by free spending on infrastructure projects (e.g. soccer stadiums and roads to key constituencies), government wages and salaries, and crude oil purchases (at notably high world prices costs) for thermal power generation.

AND TRADE DEFICIT ...

¶3. (U) Although Ghana's core export performance increased in 2008, imports showed stronger growth. Cocoa export earnings increased by 33 percent, amounting to USD 1.502 billion. Similarly gold export earnings increased by 34 percent to USD 2.246 billion in 2008. In both cases, stable to rising international commodity prices assisted with export performance. Nonetheless, total imports increased by 23.6 percent, with oil and non-oil imports growing by 12.1 percent and 32.5 percent respectively. Overall, the trade deficit and current account deficit (now estimated at 18 percent of GDP) increased dramatically.

LEADS TO A CURRENT ACCOUNT DEFICIT,

¶4. The overall balance of payments in 2008 recorded a deficit of USD 940.7 million, more than doubling the 2007 BOP deficit of USD 413.1 million. The 2008 deficit was financed by drawing on reserves and from the USD 750 million 'Eurobond' (issued in 2007, due in 2017.) In December 2008, Gross International Reserves (GIR) were USD 2.0362 billion, declining by 28.2 percent from December 2007, translating into 1.8 months of goods and services import cover. By end January 2009, the GIR continued to decline to USD 1.940 billion, providing only 1.7 months of import cover. (NOTE: three to four months of import cover is a traditional benchmark for a minimum reserve

position. END NOTE.) Between December of 2008 and January 2009, financial inflows dropped by more than 30 percent, an exceptional decline far above the 3-year average of an 11 percent decline for that same period.

AND A WEAKENING CURRENCY,

¶5. Thus, given the budgetary, trade and financial deficits that grew in 2008, it is no surprise that Ghana's cedi has depreciated by more than 30 percent against the U.S. dollar in the past 12 months.

WHICH DRIVES INFLATION

¶6. (U) Inflation surged to 20.3 percent in February 2009, with inflationary pressures evident in both imports and domestic products. This is the highest inflation figure in Ghana since January 2004. The Bank of Ghana (BoG) pointed to external factors as contributing to inflation, including rising global food and energy prices and exchange rate depreciation.

REQUIRING TIGHTER MONETARY POLICY

¶7. (U) To restore macroeconomic stability, the BoG's Monetary Policy Committee (MPC) has called for efforts to address the fiscal and current account deficits. In order to tame inflation over the coming year, the BoG called for a tightening in the money supply. As a first step, on February 24, 2009, the BoG increased its prime rate from 17 percent to 18.5 percent. Furthermore, short-term securities rates may have to rise from the current 24 percent to above 30 percent. If these measures are not taken, the BoG expects inflation to persist beyond the second quarter with a 22 percent inflation rate by the end of 2009.

...THAT CAN HURT GROWTH

¶8. (U) Industry and bank officials criticized the BoG's prime rate hike. They argue the decision will stifle business growth and could result in an increase in non-performing loans. Lending rates by banks are expected to rise above 35 percent as the prime rate directly impacts commercial interest rates charged by banks. Industry complains that high domestic interest rates paired with the global credit crunch will have a severe impact on output.

¶9. (U) COMMENT: The restoration of Ghana's macroeconomic stability demands fiscal restraint by the Government of Ghana. The new administration's 2009 budget plan (to be reported on SEPTEL) aspires to more prudent spending, but the government is already saddled with must-pay bills and commitments initiated by the prior government. In the face of diminished access to international capital, even worthwhile projects in Ghana may suffer for lack of financing. Managing the depreciation of the cedi in the face of dwindling foreign exchange reserves and declining remittances presents a considerable economic challenge for the new government. Without IMF assistance and a corresponding external imperative to contain government spending, it is unclear what course Ghana will chart through current economic conditions. END COMMENT.

Teitelbaum